LEGISLATIVE SERVICES AGENCY
OFFICE OF FISCAL AND MANAGEMENT ANALYSIS

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FISCAL IMPACT STATEMENT

LS 6989 **DATE PREPARED:** Jan 3, 2002
BILL NUMBER: SB 499 **BILL AMENDED:**

SUBJECT: Research Expense Tax Credits.

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FUNDS AFFECTED: X GENERAL
X DEDICATED
FEDERAL

IMPACT: State

Summary of Legislation: This bill increases the amount of the Research Expense Tax Credit from 5% to 20% of a taxpayer's Indiana qualified research expenses. The bill removes current limitations on the credit for a taxpayer who has income apportioned to the state for a taxable year and allows unused Research Expense Tax Credits to be transferred to another taxpayer in return for financial assistance. The bill extends the credit through 2007.

Effective Date: July 1, 2002.

Explanation of State Expenditures: This bill directs the Department of Commerce to establish a Research Expense Tax Credit Benefit Certificate Transfer Program. This program would allow taxpayers with unused Research Expense Tax Credits to transfer those credits to another unaffiliated taxpayer under certain conditions. The person eligible to receive the transfer credits must meet the following conditions:

1) provide private financial assistance to the person who accrued the Research Expense Tax Credit in an amount equal to at least 75% of the transferred tax benefit,
2) obtain approval from the Department of Commerce, and
3) comply with the filing requirements of this program.

It is estimated that the Department would need an additional PAT II-level employee in order to meet the provisions of this bill. Annual salary, fringe, and indirect expenses for a PAT II-level employee are estimated at $45,498 in FY 2003 and $45,448 in FY 2004.

The funds and resources required above could be supplied through a variety of sources, including the following: (1) Existing staff and resources not currently being used to capacity; (2) Existing staff and resources currently being used in another program; (3) Authorized, but vacant, staff positions, including those positions that would need to be reclassified; (4) Funds that, otherwise, would be reverted; or (5) New appropriations. The December 3, 2001, state manning table indicates that the IDOC has 18 vacant full-time positions, 3 of which are PAT II-level positions. Ultimately, the source of funds and resources required to satisfy the requirements of this bill will depend upon legislative and administrative actions.

The Department of State Revenue will also have additional administrative expenses associated with developing tax forms, instructions, and computer programs to accommodate the changes in the credit along with the new transfer program.

Explanation of State Revenues: This bill eliminates the apportionment factor for the Research Expense Credit and increases the credit from 5% to 20% for tax years beginning January 1, 2003. It is estimated that these changes will result in a revenue loss ranging from $22.5 M to $34.3 M in FY 2003 (due to changes in estimated quarterly payments) and $46.3 M to $71.3 M in FY 2004.

This bill also allows this credit to be transferred to other taxpayers under the Research Expense Tax Credit Benefit Certificate Transfer Program described above. This program will result in an additional revenue loss over and above the amount previously noted. The additional amount could be *potentially significant* since the other changes in the bill will greatly increase the amount of credits available to taxpayers and the current credit is not refundable, but may be carried forward. The amount of transferred Research Expense Tax Credit must be used in the year in which private financial assistance is provided to the person who accrued the credit.

Over the past four years, the current Research Expense Credit has ranged from $9.2 M in FY 1996 to $24.2 M in FY 1999. It is difficult to estimate the exact impact of continuing this tax credit since it is dependent on both the amount of research expenses individual taxpayers make during the year and their total tax liability.

Apportionment Provision: This modification would mean that the credit is based on the taxpayer's Indiana qualified research expenses, rather than the lesser of its Indiana qualified research expenses or its apportioned research expenses for the tax year beginning January 1, 2003. Currently, only businesses that do not have income apportioned to the state for a taxable year may calculate their credit based on only Indiana research expenses.

This change would lower the tax liability for multi-state, Indiana-domiciled companies that conduct a significant proportion of their research in Indiana, compared to the research conducted through their non-Indiana operations. Elimination of the apportionment factor will allow all companies to compute their tax credit based on the amount of research actually conducted in the state. It is unknown how many Indiana businesses would be affected by this change.

Rate Change: The bill also increases the percentage of credit which may be taken for research and development activities from 5% to 20%.

Extension of Expiration Date: This bill also extends the expiration date from December 31, 2002, to December 31, 2007, which will impact revenue collections for FY 2003 to FY 2008.

With additional incentives created for research and development activity based in the state of Indiana, the revenue loss from this credit could increase by an indeterminable amount. The credit provides $200,000 for each $1 M in new research expenses. Increased expenditures on research activities could also generate additional Adjusted Gross Income and Sales Tax revenue if these expenses are used to hire additional employees or purchase related equipment.

The Research Expense Tax Credit affects revenue collections deposited in the General Fund and the Property Tax Replacement Fund.

Explanation of Local Expenditures:

Explanation of Local Revenues:

State Agencies Affected: Department of Commerce; Department of State Revenue.

Local Agencies Affected:

Information Sources: Department of State Revenue.